Annual Report
Arrowhead Water Products Ltd.

Canada's Own Arrowhead Water

CONSOLIDATED FINANCIAL STATEMENTS

For the years ended September 30, 2006 and 2005

To the Shareholders

The following is a brief report with respect to the business success of Arrowhead Water Products in the 2006 fiscal year. This is a summary of the Company's achievements in the past year and the corporate objectives for 2007.

About Arrowhead

Arrowhead is Canada's largest Canadian owned, publicly traded water company which is engaged in the production, sales and distribution of large format bottled drinking water through two distinct channels, which are the Western Canadian retail market and the direct delivery to homes and offices in Alberta. Arrowhead produces and delivers bottles of reverse osmosis, distilled and natural spring water as well as providing bottled water coolers.

Mission Statement

Arrowhead Water Products will be an innovative, pre-eminent provider of water solutions in Western Canada with emphasis on quality, professionalism, service and shareholder value.

President's Report

Dear Shareholder:

For Arrowhead Water Products, fiscal 2006 was a year with two distinct priorities:

Firstly to improve operational efficiencies and return Arrowhead to profitability after the financial results from fiscal 2005. These efficiencies and changes were in place by the end of the second quarter and the results where evident by the end of fiscal 2006. The following results summarize this success:

- Sales increased from $7,855,542 to $8,871,385;
- Cash flow from operations in fiscal 2006 increased to $923,324 from $(6,755), an improvement of $930,079 over 2005;
- Cash flow generated from operations in the first half of fiscal 2006 was $328,891 as compared to $594,433 in the second half of fiscal 2006, an 81% improvement;
- The net loss in fiscal 2006 was $193,084, an improvement of $645,587 from the net loss of $838,671 in fiscal 2005; and
- Comparing the net income from the first half of fiscal 2006 to the second half of fiscal 2006 showed an improvement of $234,350 from a net loss in the first half of fiscal 2006.

The second priority was for Arrowhead to align itself with the proper management and staff to maximize its potential in the Western Canadian retail grocery market with existing and new products. The proof of the success in this area is:

- The financial success mentioned above;
- The introduction of a new innovative product – a 15 liter recyclable bottle - with sales starting in the first quarter of 2007;
- The purchase and successful installation of a new Siappi blow molding machine to manufacture the new 15 litre bottles; and
- Upgrading of bottling equipment to add a line dedicated to the 15 litre bottles.

The future operations of Arrowhead will now be focused on combining and managing the expanded business that it has established over the past two years. Arrowhead will be challenged with improving gross margins and controlling operating expenses while simultaneously maintaining annual sales growth in the 15% to 25% range. Going forward, the Company's focus will be first and foremost on improving its profitability through both revenue growth and cost controls. In the first quarter of 2007, the Company has continued with the success achieved in the second half of fiscal 2006 and has also introduced its new 15-litre product into the market place. By the end of the second quarter of fiscal 2007, the new 15-litre product is projected to be listed with at least three major western grocery store chains.

I would like to thank the many dedicated employees of Arrowhead for their support and commitment in what has been a very turbulent yet highly progressive couple of years. Not only have sales more than doubled in the last three years, but we also changed how and where the Company managed its business. I would like to thank Donald Wood, who joined Arrowhead in April of 2006, as Director of Sales and Marketing. His assistance in operations, ability in securing our existing retail business and desire to grow our business throughout Western Canada has been invaluable.

The Directors would like to thank the Company's shareholders for continued support. Please be assured that we remain more committed than ever to provide our shareholders, customers and employees with the support and governance that our responsibilities dictate.

R. Daniel DeMaere
President and Chief Financial Officer

ARROWHEAD WATER PRODUCTS LTD.
MANAGEMENT DISCUSSION & ANALYSIS ("MD&A")
Form 51-102F1
FOR THE YEAR ENDED SEPTEMBER 30, 2006

This Management Discussion and Analysis ("MD&A") should be read in conjunction with the audited annual financial statements of Arrowhead Water Products Ltd. ("Arrowhead" or the "Company") for the year ended September 30, 2006. Additional information with respect to Arrowhead can be found on SEDAR at www.sedar.com. This MD&A is dated as of January 26, 2007. The reporting and measurement currency is the Canadian dollar.

This MD&A contains forward-looking statements. Forward-looking statements are based on current expectations that involve a number of risks and uncertainties which could cause actual events or results to differ materially from those reflected in the MD&A. Forward-looking statements are based on the estimates and opinions of Arrowhead's management at the time the statements were made. Arrowhead assumes no obligation to update forward-looking statements should circumstances or management's estimates change.

OVERALL PERFORMANCE

The water industry in Canada continues to provide many opportunities for growth and advancement. Arrowhead is engaged in the production, distribution, and sales of large format (15 litre and 18.9 litre) bottles of drinking water. Arrowhead's distribution channels include the Western Canadian retail grocery market and the residential and office market in Alberta. Arrowhead's revenues are derived from two main channels: Retail water sales (71% of total revenue) and Home and Office (29% of total revenue). For the last few years, the North American bottled water industry has experienced declining revenues associated with the Home and Office channel, while the revenue derived from the retail water channel has experienced double digit growth.

By focusing on the retail channel, it is Management's view that the Company can significantly improve sales, cash flow and profitability, by executing on this strategy. Arrowhead has embarked upon a number of new initiatives for the year, driving the Company as an innovator and leader in Western Canada. We are on track integrating these changes, poised for solid growth and increased cash flow for fiscal 2007 and beyond.

Highlights for the Year

- Sales increased 13% to $8,871,385 from $7,855,842;
- Over the last 3 years, sales have increased more than 100% from $4,272,652 in 2003;
- Net loss of $193,084, compared to a net loss of $838,671 for fiscal 2005, an improvement of $645,587;
- Total expenses decreased 9% to $3,537,578 from $3,870,206, an improvement of $332,628;
- Cash flow from operations increased to $923,324 from $(6,755), an improvement of $930,079;
- Launched a new innovative product – a 15 litre recyclable bottle - with sales beginning in Q1 of 2007 to one major grocery store chain in Western Canada and will expand to a minimum of three major grocery store chains by the end Q2;
- Purchased a new Siappi blow molding machine for 15 litre production;
- Upgraded bottling equipment, increasing daily production capacity in both Edmonton and Calgary plants and added a second washer/filler line dedicated to our 15 litre production.

The before noted items have brought many operating and personnel changes to Arrowhead over the year. The most significant financial changes have occurred in the last six months of fiscal year ended September 30, 2006. For the first six months of fiscal 2006, Arrowhead reported a net loss of $213,717. For the second half of 200, Arrowhead has recorded a profit of $20,633, an improvement of $234,350. Making these results even stronger in the second half of fiscal 2006 is the fact that costs for planning, setting up and selling the new 15 liter product are included while sales will not be realized until fiscal 2007. Substantially, all these costs were one-time and non-recurring in nature, but were incurred with the view of preparing Arrowhead for its next stage of sales growth. From the positive results achieved in the first quarter of 2007, management is forecasting this positive trend in net income to continue.

Going forward in fiscal 2007, Arrowhead is now integrated and poised for another round of growth as it continues to capture an increasing share of the Western Canada retail market.

- Its productive capacity has doubled in both Calgary and Edmonton;
- The geographic reach of its delivery fleet has increased with the recent additions of semi-trucks and trailers; and
- Its geographic coverage continues to grow and spans from Vancouver, B.C to Thunder Bay, Ontario, and into northern B.C and Alberta, through both Arrowhead-owned operations and third-party co-packer agreements;

In subsequent years, Arrowhead has faced challenges with returning gross margins to historical rates of 40-45% and controlling operating expenses while simultaneously maintaining annual sales growth in the 15-25% range. In fiscal 2006 Arrowhead's gross margin improved to 38% from 37% while administrative expenses were reduced by $332,628 to 40% of sales from 49% of sales in 2005. Sales increased 13% over fiscal 2005. Going forward, the Company's focus will again be first and foremost on improving its profitability through revenue growth and cost controls. As a result of new products being available for sale and an expanding sales territory to sell them in, Arrowhead is forecasting sales growth to increase substantially year over year.

Overview

Arrowhead is a publicly traded company, listed on the TSX Venture Exchange under the symbol "AWP-A". The Company is engaged in the bottling and distribution of water products in Western Canada.

Arrowhead is Canada's largest Canadian-owned, publicly-traded water company engaged in the production, sales and distribution of large format (15 litre and 18.9 litre) bottles of drinking water. Arrowhead sells reverse osmosis, distilled and natural spring water as well as providing water coolers for dispensation. Buyers of the water do so as a replacement or alternative to their municipal supply.

These year-end consolidated financial statements include the accounts of Arrowhead and its wholly owned subsidiaries, Arrowhead Spring Water Ltd. and 351222 Alberta Ltd. (collectively the "Company"). All inter-company transactions and balances have been eliminated upon consolidation.

RESULTS OF OPERATIONS

For the year ended September 30, 2006

Revenues

Revenues for the year ended September 30, 2006 were $8,871,385 as compared to $7,855,842 for the year ended September 30, 2005. This represents an increase in revenue of $1,015,543 or 13% when compared to the same period last year.

Arrowhead's revenue is derived from three main channels:

1) Retail water sales;
2) Home and office water sales; and
3) Cooler rentals and other sales.

Results from these three channels were:

1) Retail sales for 2006 increased to $6,273,564 from $5,086,176 a 23% increase;
2) Home and office sales decreased to $2,279,245 from $2,420,242 in 2005, a 6% decline; and
3) Cooler rentals and other sales decreased to $318,576 from $349,424 a 10% decrease.

Water sales growth from the retail channel has again experienced double digit growth, while the home and office channel has declined. The decline in the home and office channel is a trend being experienced by most companies in our industry right across Canada.

Cost of sales and gross margin

During the year ended September 30, 2006, the total cost of sales where $5,534,409 (representing 38% of total revenues). This is compared to $4,986,082 for the year ended September 30, 2005 (representing 37% of total revenues).

For the year ended September 30, 2006, gross margins increased to 38% of revenue as compared to 37% of revenue for the year ended September 30, 2005. This increase resulted from improved plant efficiencies and more effective delivery solutions. The majority of these improvements occurred in the second half of fiscal 2006 and will have a greater impact on fiscal 2007.

The cost of sales increase of $548,327 for the year resulted mainly from outsourced delivery costs to retail locations outside of Alberta. These costs increased to $680,142 from $278,721 an increase of $401,421. Sales in these areas also increased substantially from $263,623 to $685,094 in 2006. All other cost of sales items either decreased or only slightly increased except for Gas and oil, which increased to $497,162 from 392,971 in 2005.

The Company's goal will be to steadily improve the gross margin of 38% in 2006 (2005 – 37%) to 40% in 2007.

Sales and marketing

Expenses incurred in sales and marketing consisted primarily of salaries, sales commissions, travel and other costs required to retain existing clients and develop new client relationships. Other expenses such as advertising, promotional materials, trade shows and other marketing programs are also included in this category. Sales and marketing costs for the year ended September 30, 2006 were $349,325 as compared to $384,775 for year ended September 30, 2005 an 9% decrease. The 2007 sales and marketing budget will be focused on expanding Arrowhead's existing retail business and on expanding into new retail chains through out Western Canada.

General and administrative

General and administrative expenses include management and administrative personnel, professional services, training, office and occupancy costs as well as other costs associated with operations including bad debts. General and administrative costs for the year ended September 30, 2006 were $1,922,466 as compared to $2,407,363 for the prior year a reduction of $484,897. This represents a 20% decrease in general and administrative costs over the prior year. The main

reason for this was wages and benefits which where $709,552 in 2006 and $983,028 in 2005 an improvement of $273,476.

Management exceeded its goal in reducing administrative costs to 22% of sales in 2006 from 31% in 2005. The focus for 2007 will be to continue to maintain administrative costs at 2006 levels.

Amortization

For the year ended September 30, 2005, the amortization of tangible and finite-life intangible assets represents the normal expense consistent with the Company's amortization policy. The amortization expense for 2006 was $1,056,861 as compared to $861,735 in 2005. With the Company's large investment in fixed assets over the past three years, amortization will continue to increase in future years.

Operating profit before interest, amortization, stock-based compensation and taxes

For the year ended September 30, 2006, the operating profit before interest, amortization, stock-based compensation and taxes was $1,065,185 compared to $77,622 for the year ended September 30, 2005, an increase of $987,563.

Based on its results in the first quarter of 2007, management expects that operating profit before interest; amortization, stock-based compensation and taxes will improve significantly again in fiscal 2007.

Stock-based compensation

The Company recognizes compensation expense when stock options are granted under the fair value method. The fair value of stock options is determined using the Black-Scholes option pricing model. This expense is a non-cash expense, the cumulative effect of which is reflected in Contributed Surplus on the balance sheet.

For the year ended September 30, 2006, the Company issued 675,000 stock options to employees of the Company. In the third quarter the Company issued 625,000 stock options and in the fourth quarter issued 50,000 stock options all at a price of 0.32 per share. The compensation costs for the stock options resulted in a charge to income of $67,065. For further details on the stock based compensation calculations, refer to note 11(e) of the Annual Audited Financial Statements dated September 30, 2006.

Income taxes

For the year ended September 30, 2006, the Company has no future income tax expense or recovery of as compared to a future income tax recovery of $142,535 in fiscal 2005. The income tax recovery available for future years is $270,699 but is not recognized in these statements.

Net profit (loss) after taxes

For the year ended September 30, 2006, the Company reported a net loss of $193,084. This compares to a net loss $838,671 for the year ended September 30, 2005, an improvement of $645,587. With a focus on growth in existing and expanding retail markets combined with cost reduction strategies, management believes Arrowhead's profitability will continue to improve in 2007.

Working Capital

For the year ended September 30, 2006, the working capital position improved slightly to 1.08:1 from 1.03:1. With an improved working capital position to start 2007 and with the availability of a $750,000 operating loan that is fully available at year-end, management is confident that it has sufficient working capital to meet its 2007 goals.

Financial Instruments

Canadian generally accepted accounting principles require that the Company disclose information about fair value of its financial assets and liabilities. Fair value estimates are made at the balance sheet date, based on relevant market information and information about the financial instrument. These estimates are subjective in nature and involve uncertainties in significant matters of judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect these estimates.

Liquidity

The Company in the past has financed its operations mainly through cash generated by operations. However, to fund its purchase of fixed assets in fiscal 2006 the Company's long-term debt obligations increased by $825,329 for the year. As of September 30, 2006, Arrowhead had cash and cash equivalents of $31,010 compared to $265,743 at September 30, 2005, representing a $234,733 decrease. Management feels that existing cash and projected cash flow is sufficient to meet 2007 cash flow requirements.

Capital Resources

The Company's balance sheet carries a balance of long-term debt and share capital. In the past Arrowhead has demonstrated its ability to raise additional capital through issuances of debt and equity. The Company has purchased $1,702,524 in capital assets, increased production capabilities and opened up new sales markets in Western Canada. Fiscal 2007 is now set to utilize these capital resources through increasing sales and return the company to profitability.

Goodwill

Goodwill represents the excess of the purchase price over the market price of acquired businesses. Effective October 1, 2002, the Corporation adopted the new accounting standard whereby goodwill is no longer amortized but is subject to an annual review for impairment. Management believes that based on the following: 1) improved cash flow of $930,079 over 2005, 2) positive results achieved in Q1 of 2007, 3) Forecasts for the next three years are positive and will focus on growth and cost reduction, no impairment in the carrying balances of Arrowhead's goodwill is evident at September 30, 2006.

Outstanding Share Debt

At September 30 2006, the Company had 30,832,530 Class A Common Shares (2005 – 30,832,530), 1,445,000 stock options (2004 – 1,418,000) and no warrants (2005 – 348,837) to acquire common shares, issued and outstanding. For details of share capital please refer to note 11 of the Annual Audited Financial Statements dated September 30, 2006.

Arrowhead's Financial Information

Copies of Arrowhead's other financial information and disclosure can be viewed at www.SEDAR.com.

ARROWHEAD WATER PRODUCTS LTD.

Consolidated Financial Statements

For the years ended September 30, 2006 and 2005

To the Shareholders of Arrowhead Water Products Ltd:

Management is responsible for the preparation and presentation of the accompanying consolidated financial statements, including responsibility for significant accounting judgments and estimates in accordance with Canadian generally accepted accounting. This responsibility includes selecting appropriate accounting principles and methods, and making decisions affecting the measurement of transactions in which objective judgment is required.

In discharging its responsibilities for the integrity and fairness of the consolidated financial statements, management designs and maintains the necessary accounting systems and related internal controls to provide reasonable assurance that transactions are authorized, assets are safeguarded and financial records are properly maintained to provide reliable information for the preparation of financial statements.

The Board of Directors and the Audit Committee are composed primarily of Directors who are neither management nor employees of the Corporation. The Board is responsible for overseeing management in the performance of its financial reporting responsibilities, and for approving the consolidated financial statements. The Audit Committee has the responsibility of meeting with management and external auditors to discuss the internal controls over the financial reporting process, auditing matters and financial reporting issues. The Committee is also responsible for recommending the appointment of the Corporation's external auditors.

Meyers Norris Penny LLP, an independent firm of Chartered Accountants, is appointed by the shareholders to audit the financial statements and report directly to them; their report follows. The external auditors have full and free access to, and meet periodically and separately with, both the Audit Committee and management to discuss their audit findings.

January 26, 2007

(signed) "Rene E. Amirault"

Rene E. Amirault, Chief Executive Officer

(signed) "Dan DeMaere"

Dan DeMaere, Chief Financial Officer

INDEPENDENT AUDITORS' REPORT

To the Shareholders of Arrowhead Water Products

We have audited the consolidated balance sheet of Arrowhead Water Products as at September 30, 2006 and the consolidated statements of loss and deficit, and cash flows for the year then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the company as at September 30, 2006 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

The financial statements as at September 30, 2005 and for the year then ended were audited by other auditors who expressed an opinion without reservation on those statements in their report dated January 20, 2006.

Meyers Norris Penny LLP

Calgary, Alberta
January 26, 2007

Chartered Accountants

MNP

ARROWHEAD WATER PRODUCTS LTD.

Consolidated Balance Sheets

As at September 30

	2006	2005 *(restated)*
Assets		
Current		
Cash	$ 101,214	$ 794,251
Accounts receivable		
Trade	1,319,912	1,132,165
Goods and services tax recoverable	161,841	82,336
Inventory	158,571	147,009
Prepaid expenses and deposits (Note 3)	86,192	72,500
	1,827,730	2,228,261
Long-term deposits (Note 3)	74,571	265,668
Property, plant and equipment *(Note 4)*	5,726,555	4,690,360
Intangible assets *(Note 5)*	272,430	320,568
Goodwill *(Note 6)*	1,396,656	1,396,656
	$ 9,297,942	$ 8,901,513
Liabilities		
Current		
Bank indebtedness *(Note 7)*	$ 70,204	$ 528,509
Accounts payable and accrued liabilities	502,477	681,940
Due to shareholders *(Note 8)*	-	15,695
Current portion of refundable deposits *(Note 9)*	541,479	486,193
Current portion of long-term debt *(Note10)*	577,212	441,632
	1,691,372	2,138,018
Refundable deposits *(Note 9)*	2,005,114	1,709,819
Long-term debt *(Note 10)*	1,697,983	1,008,234
	5,394,469	4,872,022
Commitments *(Note 12)*		
Shareholders' Deficiency		
Share capital *(Note 11(b))*	4,341,632	4,341,632
Contributed surplus *(Note11(e))*	217,021	149,956
Deficit	(655,180)	(462,097)
	3,903,473	.4,029,491
	$ 9,297,942	$ 8,901,513

Approved by the Board:

(signed) "Dan DeMaere" , **Director**

(signed) "Rene E. Amirault" , **Director**

See accompanying notes

Consolidated Statements of Loss and Deficit

Years ended September 30

	2006	2005 (restated)
Sales	$ 8,871,385	$ 7,855,842
Cost of sales	5,534,409	4,986,082
Gross profit	3,336,976	2,869,760
Expenses		
Sales and marketing	349,325	384,775
General and administrative	1,922,466	2,407,363
Interest	141,861	84,377
Stock-based compensation	67,065	131,956
Amortization	1,056,861	861,735
Total expenses	3,537,578	3,870,206
Loss from operations	(200,602)	(1,000,446)
Gain on sales of assets	7,518	19,240
Loss before income taxes	(193,084)	(981,206)
Future income taxes recovery *(Note 13)*	-	142,535
Net loss for the year	$ (193,084)	$ (838,671)
Retained earnings (deficit), beginning of year as previously stated	(345,750)	492,921
Correction of an error *(Note 16)*	(116,346)	(116,346)
Retained earnings (deficit), beginning of year as restated	(462,096)	376,575
Deficit, end of year	$ (655,180)	$ (462,096)
Loss per share *(Note 11(c))*		
Basic and diluted	$ (0.01)	$ (0.03)

See accompanying notes

ARROWHEAD WATER PRODUCTS LTD.

Consolidated Statements of Cash Flows

Years ended September 30

	2006	2005
Cash provided by (used for):		
Operating activities		
Net loss	$ (193,084)	$ (838,671)
Items not affecting cash		
Amortization	1,056,861	861,735
Future income taxes	-	(142,535)
Stock-based compensation	67,065	131,956
Gain on sales of assets	(7,518)	(19,240)
	923,324	(6,755)
Net change in non-cash working capital items *(Note 14)*	(471,969)	(243,607)
	451,355	(250,362)
Financing activities		
Repayments of advances to shareholders	(15,695)	(38,212)
Issuance (repayment) of long-term debt	277,166	539,322
Issuance of share capital	-	1,940,627
Refundable deposits	350,581	397,211
	612,052	2,838,948
Investing activities		
Long term deposits	191,097	(227,301)
Proceeds on disposal of property, plant and equipment	213,287	40,280
Purchases of property, plant and equipment	(1,702,524)	(1,907,112)
Purchase of intangible assets	-	(72,010)
	(1,298,140)	(2,166,143)
Increase (decrease) in cash	(234,733)	422,443
Cash, beginning of year	265,743	(156,700)
Cash, end of year	$ 31,010	$ 265,743
Cash is comprised of:		
Cash	$ 101,214	$ 794,251
Bank indebtedness *(Note 7)*	(70,204)	(528,508)
	$ 31,010	$ 265,743
Supplemental information		
Cash interest paid	$ 141,861	$ 84,377

See accompanying notes

Note 1 - Basis of Presentation

Arrowhead Water Products Ltd. ("the Corporation") is a public corporation listed on the TSX Venture Exchange. The Corporation is engaged in the bottling and distribution of water products in Western Canada.

The consolidated financial statements include the accounts of Arrowhead Water Products Ltd. and its wholly owned subsidiaries, Arrowhead Spring Water Ltd. and 351222 Alberta Ltd. (collectively the "Corporation").

Certain prior year comparative information has been reclassified to conform with current year presentation.

Note 2 - Significant Accounting Policies

The financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles. Because a precise determination of many assets and liabilities is dependent on future events, the preparation of financial statements necessarily involves the use of estimates and approximations which have been made using careful judgment. The consolidated financial statements have, in management's opinion, been properly prepared within reasonable limits of materiality and within the framework of the significant accounting policies summarized below.

a) Inventory

Inventory of containers, coolers, and supplies is stated at the lower of cost and net realizable value with cost being determined on a first-in, first-out basis.

b) Property, plant and equipment

The Corporation records its property, plant and equipment at cost. Depreciation and amortization is provided at the following annual rates and methods:

Water coolers	10 years straight line basis
Bottles	10 years straight line basis
Manufacturing equipment	20% declining balance basis
Vehicles	30% declining balance basis
Office furniture and fixtures	20% declining balance basis
Computer equipment	30% declining balance basis
Leasehold improvements	Straight line over the term of the lease
Buildings	5% declining balance basis
Property (well site)	20% declining balance basis

Note 2 - Significant Accounting Policies *(Continued)*

c) Intangible assets

The Corporation identifies fixed-life intangible assets, such as customer lists and branding, acquired on business acquisitions and capitalizes these amounts at cost. Amortization is provided on a straight-line basis over their useful lives of 5 to 10 years. Intangible assets also includes deferred development costs for new products or processes whose feasibility has been established and for which a future market is clearly established. These costs are amortized on a straight-line basis over periods not to exceed 5 years.

d) Financial instruments

The Corporation's financial instruments consist of accounts receivable, bank indebtedness, accounts payable and accrued liabilities and due to shareholders. The fair value of these financial instruments approximate their carrying values due to the short-term maturities of these items.

e) Foreign currency translation

The Corporation's functional currency is the Canadian dollar. Monetary assets and liabilities denominated in foreign currencies are translated at the exchange rates in effect at the balance sheet date. Non-monetary assets and liabilities denominated in foreign currencies are translated at rates in effect on the date the assets were acquired or liabilities were assumed. Revenues and expenses are translated at the rates of exchange prevailing on the transaction dates. Gains and losses on translation are reflected in income when incurred.

f) Goodwill

Goodwill representing the excess of the purchase price over the fair market value of net tangible asses acquired, is recorded at cost, less any provision for permanent impairment. Per the requirements of CICA 3062 *Goodwill and Other Intangible* Assets, the Coproration no longer amortizes its goodwill. Instead, goodwill is tested for impairment on an annual basis. The Corporation assesses impairment based on the estimated undiscounted future cash flows from operations. Impairment of goodwill is measured by comparing its book value against the estimated undiscounted future cash flows, and any impairment is included in current period earnings.

Management assessed goodwill for impairment at September 30, 2006 and concluded no write-down was required.

Note 2 - Significant Accounting Policies *(Continued)*

g) Income taxes

The Corporation follows the asset and liability method in accounting for income taxes. Under this method, future tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using substantively enacted tax rates expected to apply to taxable income in the years in which differences are expected to be reversed. Income tax expense for the period is the tax payable for the period and any change during the period in future income tax assets and liabilities. Future income tax assets are not recognized in these financial statements unless it is more likely than not that they will be realized in the foreseeable future.

h) Revenue recognition

The Corporation earns its revenue from retail grocery sales, home and office water delivery, and rental of water coolers. The Corporation recognizes sales revenues when the product is delivered to its customers and monthly rental revenues in accordance with the terms of rental contracts, provided collection is reasonably assured.

i) Earnings (loss) per share

Basic earnings per share is calculated by dividing income available to common shareholders by the weighted average number of common shares outstanding during the period.

The Corporation utilizes the treasury stock method in the determination of diluted per share amounts. Under this method, the diluted weighted average number of shares is calculated assuming the proceeds that arise on the exercise of outstanding "in-the-money" options are used to purchase common shares of the Corporation at their average market price for the period. Diluted per share amounts are not disclosed where the effect of options and warrants is anti-dilutive.

j) Stock-based compensation

Stock-based compensation expense is based on the estimated fair value of options granted at the time of the grant. The fair value is recognized in current earnings as stock based compensation expense with a corresponding increase to contributed surplus over the vesting period of the options. Upon the exercise of the stock options, consideration paid together with the amount previously recognized in contributed surplus is recorded as an increase in share capital. In the even that vested options expire, previously recognized compensation expense associated with such stock options is not reversed. In the event that unvested options are cancelled, previously recognized compensation expense associated with such stock options is reversed.

Note 2 - **Significant Accounting Policies** *(Continued)*

k) Measurement uncertainty

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the period. Accounts receivable are stated after evaluation as to their collectibility and an appropriate allowance for doubtful accounts is provided where considered necessary. Provisions are made for slow moving and obsolete inventory. Amortization is based on the estimated useful lives of Property, Plant and Equipment. Refundable deposits liability is based on evaluation of history of breakage and deposits actually refunded. Goodwill is evaluated for impairment at each financial statement date. Actual results could differ from these estimates.

These estimates and assumptions are reviewed periodically and, as adjustments become necessary, they are reported in earnings in the year in which they become known.

l) Impairment of long-lived assets

The Corporation assesses the carrying values of its property, plant and equipment, goodwill and intangible assets for impairment when circumstances indicate such amounts may not be recoverable from future operations. Generally, assets to be held and used in operations are considered impaired if the sum of expected undiscounted future cash flows is less than the assets' carrying values. If impairment is indicated, the loss is measured based on the amounts by which the assets' carrying values exceed their recoverable values. Discounted cash flows are used to measure the recoverable values of long-lived assets.

m) Leases

Leases are classified as either capital or operating leases. Leases that transfer substantially all of the benefits and inherent risks of ownership of property to the Corporation are accounted for as capital leases. At the time a capital lease is entered into, an asset is recorded together with its related long-term obligation to reflect the acquisition and financing. Equipment recorded under capital leases is amortized on the same basis as described above. Rental payments under operating leases are expensed as incurred.

Note 2 - Significant Accounting Policies *(Continued)*

n) Refundable deposits

Refundable deposits represent deposits collected on reusable water bottles at the time of bottled water sales to customers. The Corporation repays the deposits to the customer upon return of the bottle in a clean and undamaged condition. Unreturned or damaged/soiled bottles result in forfeited deposits which the Corporation retains to compensate for the loss of its bottle asset. Periodically (including at its fiscal year-end) the Corporation reconciles its fleet of bottles and takes into revenue an amount representing forfeited deposits, and charges to cost of sales a related amount for bottles consumed in operations at the weighted average net book value of the underlying bottles. The total bottle deposit liability is classified between current and long-term portions based on historical experience.

o) Recent accounting pronouncements

In January 2005, the Canadian Institute of Chartered Accountants issued new recommendations for the recognition and measurement of financial instruments, and amendments to the existing presentation and disclosure standards, effective for interim and annual financial statements with fiscal years beginning on or after October 1, 2006. Section 3855 Financial Instruments – Recognition and Measurement establishes standards for recognizing and measuring financial asset, financial liabilities and non-financial derivatives. Section 3861 Financial Instruments – Presentation and Disclosure discusses the presentation and disclosure of these items. The application of hedge accounting is covered in Section 3865 Hedges. Section 1530 Comprehensive income establishes standards for reporting and displaying certain gains and losses, such as unrealized gains and losses related to hedges or other derivative instruments, outside of net income. There have also been numerous consequential amendments under consideration. Therefore, the Corporation has not yet determined the effect of these new standards on its consolidated financial statements.

Note 3 - Long-Term Deposits

	2006	2005
Prepaid Sales Commissions, commissions paid to Ecco Sales. To be amortized at $4,375 per month until May 2008.	$ 87,225	$ 139,725
Deposits on Long-term Assets, prepaid amounts for fixed assets to be received in 2006.	-	135,375
Lease Deposits, deposits paid on leased building, leased office equipment, leased manufacturing equipment and leased vehicles.	67,098	56,628
Utility Deposits	6,440	6,440
	160,763	338,168
Less current portion	(86,192)	(72,500)
	$ 74,571	$ 265,668

Note 4 - Property, plant and equipment

	2006		
	Cost	Accumulated Depreciation and Amortization	Net Book Value
Water coolers	$ 1,069,100	$ 681,811	$ 387,289
Bottles	2,043,577	473,891	1,569,686
Manufacturing equipment	2,884,404	953,596	1,930,808
Manufacturing equipment leased	272,239	76,227	196,012
Vehicles	1,109,955	654,313	455,642
Vehicles leased	1,109,673	249,927	859,746
Office furniture and fixtures	99,057	71,249	27,808
Computer equipment	136,840	92,396	44,444
Leasehold improvements	402,923	266,616	136,307
Buildings	87,500	12,053	75,447
Property (well site)	63,867	20,501	43,366
	$ 9,279,135	$ 3,552,580	$ 5,726,555

	2005		
	Cost	Accumulated Depreciation and Amortization	Net Book Value
Water coolers	$ 1,107,419	$ 635,517	$ 471,902
Bottles	1,964,903	392,869	1,572,034
Manufacturing equipment	1,702,634	729,904	972,730
Manufacturing equipment leased	272,239	27,224	245,015
Vehicles	1,067,024	662,072	404,952
Vehicles leased	556,510	-	556,510
Office furniture and fixtures	99,057	64,297	34,760
Computer equipment	136,840	73,349	63,491
Leasehold improvements	402,923	229,418	173,505
Buildings	152,500	11,247	141,253
Property (well site)	63,867	9,659	54,208
	$ 7,525,916	$ 2,835,556	$ 4,690,360

Note 4 - Property, plant and equipment *(Continued)*

Of the property and equipment acquired during the year $553,163 (2005 - $828,749) was acquired by means of capital leases.

Amortization expense includes $298,930 (2005 - $27,224) related to equipment under capital lease.

Note 5 - Intangible Assets

	2006		
	Cost	Accumulated Amortization	Net Book Value
Intangible assets	$ 306,363	$ 84,340	$ 222,023
Deferred development costs	72,010	21,603	50,407
	$ 378,373	$ 105,943	$ 272,430

	2005		
	Cost	Accumulated Amortization	Net Book Value
Intangible assets	$ 306,363	$ 50,604	$ 255,759
Deferred development costs	72,010	7,201	64,809
	$ 378,373	$ 57,805	$ 320,568

Note 6 - Goodwill

	2006	2005
Share purchase of Arrowhead Spring Water Ltd. in 1995.	$ 375,569	$ 375,569
Business development costs occurred in 1996.	116,346	116,346
Share purchase of Calgary Bottled Water Inc. in 1996.	345,628	345,628
Asset purchase of Kodiak Water Inc. in 1998.	138,541	138,541
Asset purchase of Eagle Springs in 2004.	98,918	98,918
Asset purchase of Misty Blue in 2004.	10,000	10,000
Share purchase of Pure Water Shops in 2004.	428,000	428,000
	1,513,002	1,513,002
Less: correction for unamortized business development costs *(Note 16)*	(116,346)	(116,346)
Balance, end of year as restated	$ 1,396,656	$ 1,396,656

Note 7 - Bank Indebtedness

	2006	2005
Commercial operating line	-	528,508
Bank indebtedness	70,204	-
	$ 70,204	$ 528,508

The Corporation has a demand commercial operating line of credit available to a maximum amount of $750,000 (2005 – $750,000) bearing interest at prime plus 1%, which is collateralized by a fixed charge on all current and future property and a fixed charge on vehicles. The average interest rate on the operating line was 6.52% (2005 – 5.25%). Pursuant to the terms of the operating line, the Corporation is subject to financial covenants with respect to working capital and debt to equity. As at September 30, 2006 the Corporation was in breach of one of their covenants. The operating line is a current liability by its nature, therefore, no reclassification between long-term and current liabilities is required.

Note 8 - Due to Shareholders

Amounts due on demand to shareholders have no specified terms of repayment, are unsecured and bear interest at 12%.

Note 9 - Refundable Deposits

	2006	2005
Opening balance	$ 2,196,012	$ 1,798,801
Increase in bottle deposits charged during the year	750,581	797,211
Bottle deposits taken into revenue during the year	(400,000)	(400,000)
Ending balance	2,546,593	2,196,012
Less current portion	(541,479)	(486,193)
	$ 2,005,114	$ 1,709,819

Note 10 - Long-Term Debt

	2006	2005
Loan payable, maturing March 4, 2009, with principal repayments of $5,300 per month commencing March 4, 2004, plus interest at the Business Development Corporation's prime rate plus 1%. Collateral for the loan is a first mortgage on property, a general security agreement, corporate guarantees, and specific guarantees of two shareholders for 25% of the loan:	$ 155,700	$ 219,300
Loans payable, maturing from July 4, 2009, to January 4, 2013, with principal repayments of $17,045 per month, plus interest at the Business Development Corporation's prime rate plus .75% to 1%. Collateral for loan is General Security Agreements from 351222 Alberta Ltd., Arrowhead Spring Water Ltd., and Arrowhead Water Products Ltd.:	1,051,835	290,959
Vendor take-back note, maturing August 1, 2006, with repayments of $10,200 per month, including principle and interest commencing August 31, 2004. Interest at 1.5% per annum. Collateralized by a general security agreement. The balance remaining is presently being negotiated as per provisions in our purchase agreement.	19,568	110,330
Mortgage payable in equal monthly installments of $670 including interest at 9.5%. The mortgage was paid in full on June 30, 2006 with the sale of the building.	-	64,613
Finance contract repayable in equal monthly installments of $2,036 including interest at 9.55%. The loan was paid in full on April 30, 2006.	-	13,739
Finance contracts repayable in equal monthly installments of $7,630 including interest at rates from 5.25% to 10.35%. Finance contracts mature between January 1, 2008 and March 1, 2008. Collateralized by equipment with a combined net book value of $196,011 (2005 - $245,014).	121,686	201,960

Note 10 - Long-Term Debt *(Continued)*

	2006	2005
Lease purchases maturing between June 15, 2010 and April 15, 2011, with lease payments of $22,030 per month including interest at 6.31% to 7.62%. Purchase options $1.00 each. Collateralized by vehicles with a combined net book value of $859,746 (2005 – 556,510).	926,406	548,965
	2,275,195	1,449,866
Less current portion	(577,212)	(441,632)
	$ 1,697,983	$ 1,008,234

Pursuant to the terms of the loans payable, the Corporation is subject to financial covenants with respect to working capital, debt to equity and reporting requirements. As at September 30, 2006 the Corporation was in breach of one of their covenants. The Corporation has obtained a waiver from the lender indicating that they will not call the loans so no reclassification is required.

Future principal repayments required under the terms of the above financing agreements are as follows:

2007	$ 577,212
2008	507,948
2009	478,429
2010	406,687
2011	135,784
2012	130,735
Thereafter	38,400
	$ 2,275,195

Note 11 - Share Capital

(a) Authorized

Unlimited number of Class A voting common shares without nominal or par value
Unlimited number of Class B non-voting common shares without nominal or par value
Unlimited number of Class C preferred shares

(b) Issued

	2006		2005	
Class A Common Shares	**Number**	**Amount**	**Number**	**Amount**
Outstanding, beginning of year	30,832,530	$4,341,632	24,004,368	$2,401,005
Public short form offering ("SFO")	-	-	4,651,162	2,000,000
Costs relating to the SFO		-		(316,923)
Stock options exercised (2005)	-	-	1,747,000	182,550
Stock options exercised (2004)	-	-	350,000	-
Warrants exercised	-	-	100,000	20,000
Normal course issuer bid (2004)	-		(20,000)	
Outstanding, end of year	30,832,530	$4,341,632	30,832,530	$4,286,632
Warrants				
Broker warrants issued on SFO (1)	-	-	348,837	55,000
Share capital		$4,341,632		$4,341,632

On May 26, 2005 the Corporation closed a public offering of common shares, which were issued by way of a short form-offering document. The Company issued 4,651,162 shares at $0.43. Costs to complete this public offering totaled $261,433 including 7.5% broker cash commission. Broker warrants to purchase 348,837 common shares at $0.43 per share, expiring May 26, 2006 were also issued. A value of $55,000 has been ascribed to these warrants using Black-Scholes model and charged to costs of the SFO.

(1) The broker warrants to purchase 348,837 common shares expired May 26, 2006.

Note 11 - Share Capital *(Continued)*

(c) Earnings per share

Earnings per share calculations are based on net income as the numerator in the calculation and the weighted average number of common shares outstanding during the year (diluted 2006 – 30,914,302; 2005 – 31,911,366) (basic 2006 – 30,832,530; 2005 – 26,862,860) as the denominator.

(d) Stock Options

The Corporation has a stock option plan (the "Plan") available to officers, directors and employees with grants under the Plan approved from time to time by the Board of Directors. Under the Plan, the exercise price of each option equals the market price of the Corporation's stock at the time of issuance. The Plan provides for vesting at the discretion of the Board and expiration of the options to be five years from the date of grant. Each option can be exercised for one Class A common share of the Corporation.

The Corporation has issued stock options to acquire Class A common shares through its Stock Option Plan and has reserved 1,445,000 shares. During the year the Corporation issued 675,000 options to employees of the Corporation. The vesting period for these options is over three years, with one third being vested at the end of each year.

Note 11 - Share Capital *(Continued)*

(d) Stock Options *(Continued)*

The following options are outstanding at September 30:

	2006		2005	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding at beginning of year	1,418,000	$ 0.41	1,950,000	$ 0.11
Granted during the year	675,000	0.32	1,215,000	0.44
Expired during the year	(70,000)	0.10	-	-
Cancelled during the year	(578,000)	0.31	-	-
Exercised during the year	-	-	(1,747,000)	0.11
Outstanding and exercisable at end of year	1,445,000	$ 0.42	1,418,000	$ 0.41

The outstanding and exercisable options will expire as follows:

	Shares	Exercise Price
January 31, 2010	707,569	0.50
May 26, 2011	75,388	0.32
August 4, 2011	2,603	0.32
	785,560	

Note 11 - Share Capital *(Continued)*

(e) Stock-based Compensation

The Corporation recognizes compensation expense when stock options are granted using the fair value method whereby compensation is recorded equal to the fair value of the options granted over the term of the vesting period. The fair value of the 675,000 (2005 – 1,215,000) options granted during the year is $86,299 (2005 - $173,923). Stock based compensation expense recognized during the year was $67,065 (2005 - $131,956). The fair value for these options is estimated at the date of grant using the Black-Scholes Option Pricing Model with the following assumptions:

	2006	2005
Volatility factor of expected market price (%)	104.00	89.19
Weighted average risk-free interest rate (%)	4.04	3.65
Dividend yield (%)	-	-
Weighted average expected life of options (years)	5.00	5.00
Exercise: expiry ratio	53.34%	58.00%

The impact of the stock based compensation on contributed surplus is:

	2006	2005
Opening balance	$ 149,956	$ 18,000
Additions from issuance of stock options	67,065	131,956
Closing balance	$ 217,021	$ 149,956

Note 12 - Commitments

The Corporation is committed to future operating lease payments for office equipment, vehicles and buildings as follows:

2007	$ 330,047
2008	306,150
2009	306,828
2010	299,079
2011	135,644
Thereafter	135,643
	$ 1,513,391

Note 13 - Income Taxes

(a) Income tax provision

The provision for income taxes recorded in the consolidated financial statements differs from the results which would be obtained by applying the combined Federal and Provincial tax rate of approximately 33.62% (2005 – 33.62%) to the loss before income taxes. This difference results from the following items:

	2006	2005
Loss before income tax expense	$ (193,084)	$ (981,206)
Statutory Canadian corporate tax rate	33.62%	33.62%
Calculated expected income tax expense	(64,915)	(329,881)
Adjustments:		
Stock-based compensation	22,547	44,364
Non-deductible expenses	1,437	1,951
Benefit from tax rate reductions	-	(10,000)
Other	(60,583)	13,763
Change in valuation allowance	101,514	137,268
Income tax provision (recovery)	$ -	$ (142,535)

Note 13 - Income Taxes *(Continued)*

(b) Future income taxes

Future income taxes reflect the net tax effect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The components of the Corporation's net future income tax asset as follows:

	2006	2005
Future income tax net liabilities:		
Non-capital loss carry forwards	$ (343,649)	$ (341,717)
Difference in book and tax basis for property, plant and equipment	72,950	(30,496)
Future tax benefit not recognized in these statements	270,699	372,213
Total future tax liabilities	$ -	$ -

(c) Loss carry forwards

The Corporation has accumulated operating loss carry forwards of approximately $1,022,153, which can be used to reduce taxable income in future years. These losses, if not fully utilized, will expire as follows:

2007	$ 39,905
2008	11,803
2010	13,491
2014	2,176
2015	870,112
2026	84,666
	$ 1,022,153

Note 14 - Change in Non-Cash Working Capital

	2006	2005
Cash provided by (used for):		
Accounts receivable		
Trade	$ (187,747)	$ (257,272)
Goods and services taxes	(79,505)	35,402
Inventory	(11,562)	(14,228)
Prepaid expenses and deposits	(13,692)	(42,500)
Accounts payable and accrued liabilities	(179,463)	34,991
	$ (471,969)	$ (243,607)

Note 15 - Financial Instruments

The Corporation, as part of its operations, carries a number of financial instruments. It is management's opinion that the Corporation is not exposed to significant interest, currency or credit risks arising from these financial instruments except as otherwise disclosed.

Credit and foreign currency risk

Accounts receivable from customers originate under normal trade credit terms, are unsecured, and are therefore subject to collection risk. Management addresses this risk through its internal credit-granting policies, active accounts receivable management practices, and carries an allowance for doubtful accounts based on specific account identification and historical bad debt experience.

Management is of the opinion that any risk of accounting loss is significantly reduced due to the financial strength of the Corporation's major customers. The Corporation has four customers that account for 61% of the outstanding accounts receivable (2005 – four customers, 53%). These same four customers account for 51% of the Corporation's sales (2005 – 40%).

Presently the Corporation has very little exposure to foreign currency risk as substantially all revenues and debts are in Canadian currency. The Corporation also has no sales or purchase contracts in any foreign currency.

The following U.S. Dollar balances have been converted to Canadian dollars:

	2006	2005
Cash (bank indebtedness)	$(6,453)	$ 544
Accounts payable	(36,658)	(13,395)

Interest rate risk

The Corporation has interest bearing debt from financial institutions with rates fluctuating with bank prime.

Note 15 - Financial Instruments *(Continued)*

Fair values

Canadian generally accepted accounting principles require that the Corporation disclose information about the fair value of its financial assets and liabilities. Fair value estimates are made at the balance sheet date, based on relevant market information and information about the financial instrument. These estimates are subjective in nature and involve uncertainties in significant matters of judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect these estimates.

The fair value of cash, accounts receivable, bank indebtedness, accounts payable and accrued liabilities, and due to shareholders approximate their carrying values given the short-term to maturity of these instruments as estimated by management.

The carrying value of the Corporation's floating rate long-term debt approximates its fair value, because interest charges under the terms of the debt are based upon current Canadian bank prime rates. The fair value of the Corporation's fixed rate long-term debt is also approximated by its carrying value, as there have been no significant changes in lending rates or other conditions.

Note 16 - Correction of an Error

During the year, the Corporation determined that it had classified business development costs ("development costs") subject to amortization incorrectly with goodwill and that they had not been properly amortizing these development costs. These development costs should have been fully amortized by the end of fiscal 2004. The impact of the correction in 2005 and 2006 is a decrease to goodwill of $116,346 and a decrease to 2005 and 2006 opening retained earnings of $116,346.

Corporate Information

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R. Daniel DeMaere, President and CFO

Rene Amirault*, CEO

J. Michael Nicolichuk*

Ross O. Drysdale*

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